DEPARTMENT OF THE AIR FORCE
HEADQUARTERS UNITED STATES AIR FORCE
WASHINGTON DC

OCT 06 2006

MEMORANDUM FOR ALMAJCOM/A7/A7C
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FROM: HQ USAF/A7C
1260 Air Force Pentagon
Washington DC 20330-1260

SUBJECT: Policy for Utilities Privatization

1. The attached policy and guidance updates the Air Force Utilities Privatization (UP) program to implement changes mandated by the FY06 National Defense Authorization Act (NDAA). Please use this guidance to advocate strongly for award of our utility privatization projects in your corporate processes.

2. As we work to find efficiencies and Lean our processes, utility privatization can pay us great dividends; it is simply the right thing to do. We agree with OSD that owning and operating utility systems is not a Department core competency, and that we have a responsibility to revitalize utility systems to industry standard and keep them there. Privatization gets us out of the business of distributing utilities and allows us to focus on higher priorities.

3. The Air Force has approximately 280 systems remaining with incomplete solicitations. I ask that you source funds and push to award these contracts when economically feasible. We consider a system economically feasible when the cost of privatization is less than what the government should spend to maintain the system at industry standard. There will be cases where you do not have sufficient resources programmed to fully fund this requirement. This is where I need your leadership to source funds within your corporate process.

4. Please be prepared to discuss progress on your solicitations at the next privatization Program Management Review (PMR), scheduled for 7-9 November. If members of your staff have questions, they may contact Maj Tom Davison, HQ USAF/A7CXO, DSN 332-0885, or Mr. Ken Miller, HQ USAF/A7CXO, DSN 664-4304. This is a coordinated SAF/IEI/GCN/AQCK/FMBO/FMCO memorandum.

Del Eulberg

DEL EULBERG, Maj Gen, USAF
The Civil Engineer
DCS/Logistics, Installations & Mission Support

Attachment:
Policy for Utilities Privatization

AIR FORCE POLICY
FOR
UTILITIES PRIVATIZATION

I. REFERENCES

(a) USD(AT&L) memorandum dated 20 Mar 06
(b) USD(AT&L) memorandum dated 2 Nov 05
(c) DEPSECDEF memorandum dated 9 Oct 02
(d) DEPSECDEF DRID #49 dated 23 Dec 98
(e) SECDEF Defense Reform Initiative Report Nov 97

II. PURPOSE

Updates and supplements guidance provided by references (a) through (e) above. Addresses changes to 10 U.S.C. § 2688 enacted by Section 2823 of the National Defense Authorization Act for Fiscal Year 2006 (FY06 NDAA), Public Law 109-163. Also provides guidance on programming utilities privatization (UP) requirements, the Executive Steering Group (ESG), summary of primary requirements to award a UP contract, and resumption of contracting/solicitation activities.

III. BACKGROUND

OSD guidance and policies stem from two main initiatives driving the UP program: 1.) Remove the Department of Defense (DoD) from the business of owning, managing, and operating utilities (DRID #49); and 2.) Leverage private sector resources to revitalize utility systems (Defense Reform Initiative Report, Nov 97). The 9 Oct 02 DEPSECDEF memo stated, "Privatization allows installation commanders to focus on core defense missions and functions by relieving them of activities that can be done more efficiently and effectively by others. DRID 49 directed Defense Components to privatize every Government owned electric, water, wastewater and natural gas utility system unless security concerns required federal ownership or privatization was uneconomical." The 9 Oct 02 DEPSECDEF memo stated, "Historically, military installations have been unable to upgrade and maintain reliable utility systems fully due to inadequate funding and competing installation management priorities. Utilities privatization is the preferred method for improving utility systems and services by allowing military installations to benefit from private sector financing and efficiencies." OSD has directed that a system is economically feasible when the long-term cost of privatization is less than the government's cost of owning and maintaining the system at industry standard, for the same period of time.

IV. POLICY

A. Resumption of Contracting/Solicitation Activities. The ESG rescinded the AF pause in UP solicitations on 2 Aug 06. Consistent with statutory requirements and OSD and AF policy, MAJCOMs shall provide immediate guidance to their UP contracting agents, to include appropriate assurance of funding, for resuming solicitations and moving forward with the UP program. Solicitations should proceed on a case-by-case basis while complying with the FY06 NDAA and adhering to all OSD UP and AF UP guidance. Also on a case-by-case basis, MAJCOMs shall take steps to cancel specific solicitations where immediate contracting actions are not possible due to workload, and develop a plan for resolicitation. As a reminder, a system will not be certified exempt from privatization until the competitive and sole source solicitations are complete.

B. Solicitation for Full Title Conveyance. To solicit a full title conveyance the contracting agent shall issue a request for proposal (RFP) for a service contract, using the approved AF template. The RFP must clearly indicate the Government's intention is to convey the system by bill of sale to the successful offeror. Economic analyses of solicitations and offers received result in a Net Present Value (NPV) comparison with the Government's "should-cost" in accordance with existing UP guidance. The following factors shall be included in a full title conveyance:

1. Fair Market Value (FMV). The FY06 NDAA and OSD supplemental guidance provided the Services increased flexibility in negotiating a transfer price. The AF Certified Economic Analysis (CEA) template addresses FMV in Paragraph 8.1 of the report template. The CEA now requires the entry of the Purchase Price for the system, the Recoverable Amount of the Purchase Price, and statements addressing why the combination of the two represents FMV received. If any consideration other than payment of FMV was given for the sale of the system, the CEA also requires indication of the specific consideration and value.

2. Margin of Error (MOE). The FY06 NDAA directs the military departments to incorporate a MOE analysis into any decision to convey (privatize) a utility system prior to entering into a contract. The purpose of the MOE analysis is to minimize the risk that: (a) the cost of continued Government ownership has been overestimated, and (b) the cost of privatization has been underestimated. The AF complies with the NDAA MOE requirement by conducting two separate analyses: (a) an economic sensitivity analysis, and (b) a cost realism analysis. To minimize the risk that the cost of continued Government ownership has been overestimated, the Source Selection Team (SST) conducts an economic sensitivity analysis of the Government should-cost (GSC). Key cost factors for the GSC estimate are varied in the CEA model to establish upper and lower confidence intervals of the cost of continued Government ownership. The economic sensitivity analysis of the GSC estimate is described in Paragraph 9.0 of the AF CEA report template. To minimize the risk that the cost of privatization has been underestimated, the SST conducts a cost realism analysis of the offeror's proposal. The cost realism analysis demonstrates that the offeror understands the scope and statement of work and has proposed a realistic cost necessary to meet the requirements. A summary of the cost realism analysis is attached to the CEA report template as Attachment 6. An economic sensitivity analysis on the offeror's proposal is not conducted when a cost realism analysis is performed. Unlike the upper and lower confidence intervals of the GSC, the offeror's final proposal (cost of privatization) is firm.

The CEA report now must state the Source Selection Authority (SSA) considered the MOE analysis and determined the award of a contract is reasonable. If the SSA cannot make this determination, the SSA may conclude award is not in the best interest of the Government and elect not to award. Where the MOE analysis is particularly close, the SSA and contracting officer must exercise judgment and due diligence in making an award decision. Additionally, SAF/IEI and members of the ESG may require further MOE discussion to gain a thorough understanding of the risks involved prior to approving conveyance of the system. Conveyance approval will be documented at the ESG meeting for reference when the bill of sale is subsequently submitted to SAF/IEI for signature.

3. Contract Terms. The FY06 NDAA limits UP contract terms to 10 years unless the Secretary concerned determines a longer-term contract not to exceed 50 years will be cost effective and provides an explanation of the need for the longer-term contract, along with a comparison of costs between a 10-year contract and the longer-term contract.

a. Paragraph 8.1.2 of the revised CEA report template should provide sufficient criteria to justify exceeding a 10-year term for privatization. The Air Force has determined that 50-year contracts in conjunction with full title conveyance (i.e., no automatic reversion included) are almost always more cost effective than shorter contract terms. If contracting officers or SSAs require more specific justification, determinations may be made as a result of reviews of similar proposals, assumptions based on historical data or parametric estimating techniques, or any other solicitation-specific reasonable means.

b. For UP RFPs already issued, no action is needed to amend the RFP to require separate proposals for 10-year terms or longer. Likewise, sole source acquisitions, where the Justification and Approval (J&A) to proceed with a sole source effort with the local provider is based on either a) lack of response or b) lack of award under a prior competitive solicitation, shall not request separate proposals for each term length but rather shall request the same contract term length as the prior competitive RFP upon which the J&A was based.

c. Contracting Officers may request separate proposals in future competitive RFPs. Less than 50-year terms may yield some economic advantage in solicitations allowing less than full title transfer. The 10-year contract term shall not be compared to longer terms without considering the potential effects of subsequent periods between the expiration of the 10-year term and the extended period.

C. Congressional Notification. FY06 NDAA requires Congressional notification not less than 21 days before awarding a UP contract. Additionally, the NDAA requires a Quarterly Report to Congress not later than 30 days after the end of each quarter of a fiscal year, summarizing conveyances made during that quarter. MAJCOMs shall submit award notification packages to HQ AFCESA for review and edit. Together with HQ AFCESA, AF/A7CX will submit packages to A7C and SAF/IEI for approval and signature. HQ

AFCESA will provide the Quarterly Report to Air Staff for signature, coordination, and submission to Congress.

D. Temporary Limitation on Conveyance Authority. NDAA and OSD guidance state, "During each of fiscal years 2006 and 2007, the number of utility systems, or parts of utility systems, for which conveyance contracts may be entered into under 10 U.S.C. §2688, shall not exceed 25 percent of the total number of utility systems determined to be eligible for privatization under this authority as of January 6, 2006." Air Force does not anticipate awarding a number of UP contracts that approaches the 25% annual limitation. However, HQ AFCESA will monitor and notify HQ USAF/A7C if a sufficient number of contracts are awarded to exceed the limit.

E. Programming UP Requirements. MAJCOMs shall program contract costs for privatized utility systems in Facilities Operations (FO). For projected UP solicitations (system not yet privatized), MAJCOMs shall program in FO for the projected cost of the privatization contract (should-cost) across the FYDP, beginning with the year in which an award decision is reasonably expected. The following element of expense investment codes (EEIC) have been developed for tracking UP expenses and should be reflected in the accounting classification:

EEIC	AF Data Dictionary Title	AF Data Dictionary Description
480UE	UTIL-PRIV-ELEC-DISTR	Privatized Electrical Distribution
480UG	UTIL-PRIV-NTRL-GAS	Privatized Natural Gas Distribution
480US	UTIL-PRV-WSTWTR-COLL-TRTMT	Privatized Wastewater Collection and Treatment
480UW	UTIL-PRIV-WTR-DISTR-TRMT	Privatized Water Distribution and Treatment

UP contracts may subsequently be awarded only when an offer is technically acceptable, economically feasible (the privatization cost is less than the should-cost), and the MOE is within acceptable bounds of risk.

F. Executive Steering Group (ESG). Upon approval of this policy, UP briefings will resume at ESG meetings. HQ AFCESA will immediately re-establish the briefing schedule in consultation with the MAJCOM UP POCs. Attendees at these briefings will include the appropriate SSA or MAJCOM CE.

G. Summary of Primary Requirements to Award a UP Contract. Before a contract may be awarded, the minimum requirements include but are not limited to the following:

1. The net present value of the privatization cost shall be less than the net present value of the Government should-cost.
2. Establish the contract term length (refer to IV.B.3. above for details). A deliberate decision "by the Secretary concerned" is required to exceed the prescribed 10 year

contract term length; this requirement shall be satisfied by SAF/IEI review and approval via briefing the ESG.

3. The SSA shall consider the sensitivity analysis and brief the ESG on how MOE impacts the decision.
4. MAJCOMs and AF/A7CX shall coordinate on any increased resources required to fund privatization costs through the FYDP.
5. A 21-day Congressional notice-and-wait package shall be forwarded subsequent to briefing the ESG and preceding contract award.

H. Questions. This is a coordinated SAF/AQCK/IEI/FMCE/FMBOO; AF/A7C policy memorandum. If there are questions or additional points to be considered, please contact Maj Tom Davison, HQ AF/A7CXO, DSN 332-0885, commercial (703) 602-0885, e-mail Thomas.Davison@pentagon.af.mil; or Mr. Ken Miller, HQ USAF/A7CXO, DSN 664-4304, commercial (703) 604-4304, e-mail ken.miller.ctr@pentagon.af.mil.